

RESEARCH SPOTLIGHT

Does Democracy Lead to Economic Growth?

BY MATTHEW CONNER

For years, the debate about which form of government is economically optimal has raged among politicians and economists. Some believe that democracy is essential to sustained economic growth, while others remain skeptical of the evidence supporting this view. Meanwhile, the world has seen a move toward democracy during the past 30 years, with many totalitarian states becoming democratic. However, there is still one question at the center of this debate: Do democratic reforms bring economic growth?

In a recent article, researchers Elias Papaioannou and Gregorios Siourounis of Dartmouth College and the University of Peloponnese, respectively, sought to challenge previous findings that democracy had little to no statistically significant effect on economic growth. In contrast with prior analysis that mostly focused on differences between countries, this paper explores “within-country” growth effects. To do that, the authors compared economic outcomes before and after the enactment of democratic reforms around the world during the four decades between 1960 and 2003. This includes the so-called “Third Wave of Democratization” mainly in Africa, Asia, and Latin America and the reforms adopted in many formerly communist countries during the early 1990s.

To avoid some of the pitfalls associated with categorizing different democratic reforms, the authors created a new dataset of what they call “permanent democratic transitions.” To classify the transitions, the authors answered four general questions:

- 1) Were the legislative or presidential elections free and fair?
- 2) Were civil liberties and political rights respected?
- 3) Was the franchise inclusive of the majority of the population?
- 4) Did the elected officials enjoy real governing capacity?

The study focuses on whether the shift to a democratic government accelerates, decelerates, or has no effect on economic growth by examining the annual real per-capita GDP before and after reform. The timing of initial democratization is defined by the authors as the date of the first “free and fair” election or the adoption of a new “democratic constitution” after prolonged autocratic rule.

The authors found that shifting to a democratic government resulted in a nearly 1 percent annual increase in the

growth of gross domestic product. During the transition to democracy, however, growth drops significantly, due to the high costs related to the transition. But examination of long-run trends shows a higher stabilization level. Their analysis also shows that even moderate democratic reform can yield decent growth gains, while “reverse transitions” (backsliding away from democracy) are associated with slower growth.

Yet it still might be unclear that democratic reform is solely responsible for economic growth. Perhaps economic reforms either precede or accompany political reforms. The authors point out that their model does not distinguish

between different types of democracies, for example, presidential or parliamentary. That would be vital to addressing the traditional “public choice” and “institutional” schools of analysis, which state that certain built-in frictions, such as checks and balances in a representative system, might be more important to checking certain legislative impulses — like

restrictions on various economic freedoms — which can hinder economic growth. Also, because the authors do not take into account whether specific legal rights — say, how well the legal system protects property rights — exist in each country, it is hard to determine whether democracy is the main determinant of the increased economic growth or whether the growth can be traced to the legal regimes that might accompany the presence of democracy.

Other researchers choose to focus on specific types of cultural or legal precursors for economic growth. In a widely cited article, Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny have stated that other variables have a more positive influence on growth than the mere presence of democracy. For example, common law countries fare better than civil law countries, while predominantly Protestant countries perform better economically than either Catholic or Muslim nations.

While economic growth may be correlated with democratic reform, the direction of the causation remains a question. Papaioannou and Siourounis concede this possibility when they write that it could be “growth that consolidates the democratic process rather than political reforms causing growth.” Although their paper is a useful contribution to the empirical analysis of how governmental institutions influence development, their conclusions should — and, no doubt, will — be subjected to careful examination.

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“Democratisation and Growth”
by Elias Papaioannou and Gregorios
Siourounis. *Economic Journal*,
October 2008, vol. 118, pp. 1520-1551.